CONCLUSION

Most of the laws intended to combat pernicious alien influences on the American public through the media vest authority over such matters in the Executive Branch. FARA gives the U.S. Attorney General the power to label content. The Exon-Florio amendment controls the flow of capital. Section 606 of the Communications Act empowers the President to seize transmission media.

In some respects, these laws appear quaintly xenophobic. But the level of control that these laws authorize is a serious matter; generally, these laws are a tremendous threat to liberty and, at the same time, might be a valuable aid to national defense. Both the threat to liberty and the usefulness of these laws arise from the same factor—the broad discretion that these laws vest in the Executive Branch. However ambivalent we may be about Congress giving such powers to some instrument of the federal government, it is probably superior from the perspective of protecting individual liberty while protecting the nation that it is the Executive Branch, and not an unaccountable independent agency, where such discretion resides.

It seems appropriate, then, that the plain language of section 310 of the Communications Act did not leave the FCC with nearly so much discretion on matters of national security as the FCC and the courts have led us to believe by their perfunctory recitation of the goals of section 310(b). Nevertheless, the FCC has claimed broad discretion to interpret section 310(b). Even if that discretion existed, the FCC has exercised it unwisely and unlawfully. In direct conflict with the plain language of section 310(b)(4), the FCC has created a presumption that foreign investment disserves the public interest if it exceeds 25 percent of the equity of an American radio licensee. This policy is contrary to the FCC's legal authority under the Communications Act and thus is unlawful under the Administrative Procedure Act.

An examination of the other provisions in the

Communications Act and in related statutes reveals that it is unlikely that the FCC's zeal in enforcing 310(b)(4) is essential either to protect national security or to advance the "public interest" in any other respect. Despite their exemption from section 310(b), private carriers and cable television have not become tools of today's version of "the Hun." As telecommunications markets become increasingly global in scope, the main effect of the FCC's error will be to obstruct the natural flow of capital and to stifle competition.

APPENDIX: OTHER FEDERAL STATUTES RESTRICTING FOREIGN DIRECT INVESTMENT

Section 310(b) of the Communications Act is only one of several federal statutes that restrict foreign direct investment on an industry-specific basis. Federal statutes also restrict foreign direct investment in the air transportation, shipping, banking, mining, energy, and fishing industries. None of these statutes, however, implicates speech or the transmission of information. And, quite conspicuously, no statute restricts the foreign ownership of newspapers, publishers, motion picture studios, software companies, book stores, theaters, or video rental outlets.

Foreign participation in the air transportation industry is subject to substantial restrictions, under authority of the Federal Aviation Act of 1958,[176] as implemented by the Department of Transportation.[177] Under the Federal Aviation Act, foreign airlines are prohibited from operating in U.S. domestic air service.[178] Domestic airline operations are limited to aircraft registered in the U.S., for which only a U.S. citizen[179] or a

176. 49 U.S.C. §§ 1301-1557.
177. 14 C.F.R. §§ 211-98.
178. 49 U.S.C. § 1301(3).
179. *Id.* § 1401(a)-(b).

corporation organized in the U.S.[180] with aircraft based and used primarily in the U.S., may register. Aliens may engage in international air transportation serving U.S. and foreign destinations, but they must operate as "foreign air carriers"[181] and must acquire a permit from the Department of Transportation (DOT).[182] DOT regulations set forth the requirements for permit applications[183] and the terms, conditions, and limitations of foreign air carrier permits.[184]

Foreign companies may invest in U.S. airlines, but only to the extent that the recipient airline would remain a U.S. citizen under the Federal Aviation Act. That act requires that no more than 25 percent of the voting stock, and 49 percent of the equity, be held by foreign investors.[185] Investments below this threshold are subject to review by DOT if the investor is an air carrier that would operate jointly with the domestic airline in which it invested.[186] Certain indirect investments by foreign-owned U.S. companies in the airline industry are not regulated. A foreign-owned corporation may own U.S. aircraft and operate domestic air service if it is organized in the U.S. and if its aircraft are based and used in the U.S.[187]

Foreign investors also face two types of restrictions on their participation in the U.S. maritime industry: those on domestic transport, and those on international transport. In addition to explicit restrictions on foreign maritime investment, federal law discourages foreign investment by curtailing the operations of foreign-owned marine transport companies and

180. *Id.* § 1401(b)(1)(A)(ii).
181. *See id.* §§ 1301(22), (24).
182. *Id.* § 1372(a).
183. 14 C.F.R. § 211.
184. *Id.* § 213.
185. *See* 49 U.S.C. § 1301(16).
186. *See* 14 C.F.R. § 399.88.
187. *See* GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: IMPACT OF CHANGING FOREIGN INVESTMENT AND CONTROL LIMITS ON U.S. AIRLINES (Jan. 10, 1993).

vessels.

The Merchant Marine Act of 1920[188] contains the "Jones Act"—a law providing that merchandise moving between ports in the U.S. must be transported on U.S.-built, owned, and registered vessels.[189] Under the Jones Act, the Secretary of the Treasury has discretion to suspend these requirements with respect to countries that grant the U.S. reciprocal treatment, but only under extraordinary circumstances.[190]

The Shipping Act of 1916 sets forth a direct restriction on foreign investment.[191] The Shipping Act requires the approval of the Secretary of the Treasury before a U.S. vessel may be transferred to an alien,[192] with narrow exceptions.[193] There are also three major laws that prevent foreign vessels from carrying certain United Stats Government cargo, by authorizing or directing government agencies to ship preferentially on U.S. flag vessels on non-competitive terms. First, the Cargo Preference Act of 1954 requires that at least half of specified government cargo be transported on privately-owned flag vessels, when they are available at reasonable rates.[194] Second, the 1954 act requires that all cargoes covered must be shipped on U.S.-flag vessels, subject to waiver.[195] Third, the Cargo Preference Act of 1904 requires all items procured for or owned by the military departments to be carried exclusively on U.S.-flag vessels.[196]

Banking is also an area in which the U.S. restricts foreign activity and investment. The Foreign Bank Supervision Enhancement Act of 1991 establishes stringent rules for federal

188. 46 U.S.C. §§ 861-99.
189. *Id.* § 883.
190. *Id.*
191. *Id.* §§ 801-42.
192. *Id.* §§ 808(c), 835(b), (e).
193. *See id.* §§ 1181, 31322(a)(1)(b), 31328.
194. *Id.* § 1241(b)(1).
195. *Id.* § 1241-1.
196. *Id.* §§ 1151, 1171.

supervision of foreign banks seeking to invest or operate in the U.S.[197] The act requires federal review prior to a foreign bank's establishment of branches, agencies, or commercial lending company subsidiaries in the U.S.[198] The Act also authorizes the Federal Reserve Board to terminate a foreign bank's U.S. activities and offices if it finds that the bank has violated domestic law or engaged in unsafe or unsound banking practices.[199]

General investments by foreigners in U.S. banks are also regulated in certain circumstances. In particular, the Act requires disclosure of any purchase of shares in a national bank with the use of loans from a foreign bank that were secured by such shares.[200] Penalties can be severe—up to $25,000 per day of a continuing violation, plus additional penalties for failure to make required reports.[201]

There are also restrictions on bank operations by foreigners at the federal level. The National Bank Act provides that all directors of national banks must be U.S. citizens.[202] Further, at least two-thirds of the directors on the board of a national bank must reside in the state where the bank is located, or within 100 miles of the bank itself.[203]

Foreign investment in various sectors of the energy industry is also restricted under U.S. law. The Mining Law of 1987 limits the right to explore for minerals and to purchase lands containing mineral deposits to "citizens of the United States and those who have declared their intention to become such."[204] These prohibitions are enforced by the Department of

197. Pub. L. No. 102-242, 105 Stat. 2286 (codified in various sections of 12 U.S.C.).

198. 12 U.S.C. § 3105(d).

199. *Id.* § 3105(e).

200. *See id.* § 1817(j)(9).

201. *Id.* §§ 3110(a)(1), (c).

202. *Id.* §§ 21-215.

203. *Id.* § 72.

204. 30 U.S.C. § 22.

the Interior. Foreign-owned corporations are considered citizens of the U.S. if they are organized under U.S. law, and thus may exercise federal mining claims under the law.[205]

Foreign investment in the nuclear energy industry is largely proscribed. The Atomic Energy Act of 1954[206] effectively bars foreign ownership of companies operating in the nuclear power industry. The Act contains a section that regulates the licensing of production facilities that use nuclear materials, and prohibits the Nuclear Regulatory Commission (NRC) from issuing a license to "an alien or corporation or other entity if the NRC knows or has reason to believe it is owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government."[207] The Act also authorizes the Department of Energy (DOE) to issue leases or permits for exploring or mining nuclear source material in land belonging to the U.S.[208] Under this authority, DOE may restrict the mining rights of foreign entities.[209]

The Mineral Lands Leasing Act of 1920 restricts foreign procurement of leases to explore and extract deposits of coal, oil, oil shale, gas, and various nonfuel minerals on U.S.[210] Government lands, with certain exceptions based on reciprocity.[211] The Outer Continental Shelf Lands Act authorizes the leasing of oil and natural gas in the offshore area comprising the continental shelf of the U.S.[212] The regulations implementing the law provide that leases may be issued only to U.S. citizens, aliens, or corporations organized under the laws of the

205. *Id.* § 24.

206. Atomic Energy Act of Aug. 30, 1954, 68 Stat. 921 (codified as amended in various sections of 42 U.S.C.).

207. 42 U.S.C. § 2133(d).

208. *See id.* § 2097.

209. *Id.*

210. 30 U.S.C. §§ 181-287.

211. *Id.* § 181; 43 C.F.R. § 3102.2.

212. 43 U.S.C. §§ 1331-56.

U.S.[213]

The Federal Power Act[214] authorizes the Federal Energy Regulatory Commission to issue licenses to construct and operate power plants on public lands.[215] Under the Act, licenses may be granted only to U.S. citizens and domestic corporations.[216] Finally, under the Geothermal Steam Act of 1970,[217] the issuance of leases for geothermal steam development and utilization is restricted to U.S. citizens and corporations organized under U.S. law.[218]

The Coast Guard Authorization Act of 1989 limits foreign investment in the U.S. commercial fishing industry by imposing restrictions on foreign ownership of fishing vessels.[219] Vessels documented for U.S. fisheries must be owned by U.S. citizens.[220]

213. 43 C.F.R. § 3102.1 (Interior Dept.).
214. 16 U.S.C. §§ 791(a)-825.
215. *Id.* § 797(a).
216. *Id.* § 797(e).
217. 30 U.S.C. §§ 1001-27.
218. *Id.* § 1015.
219. 46 U.S.C. § 12102.
220. *Id.* § 12102(c).

4

4

Ownership and Control

LIKE ANY COMPLEX regulatory constraint, the foreign-ownership restrictions in the Communications Act challenge managers, aided by their lawyers and investment bankers, to structure the ownership and control of a multinational telecommunications firm so that, on the one hand, the firm complies with the law and, on the other, it maximizes returns to shareholders by exploiting competitive opportunities while trying to counteract the agency costs engendered by the regulation. As briefly mentioned in chapter 3, the FCC enforces section 310(b)(4) through a protracted waiver process. In this chapter, we examine how foreign investors have structured the ownership and control of their investments in U.S. telecommunications firms either to avoid seeking waivers or to facilitate the securing of waivers that the FCC can be expected to grant.

TRANSACTIONS COSTS, AGENCY COSTS, AND THE STRUCTURE OF THE FIRM

Two questions lie at the heart of economic analysis of the firm. First, what is the optimal size of the firm? This question in turn invites many others. What are the optimal scale and scope of the firm's activities? How much of the total demand for a given product should the firm attempt to supply? Should the firm produce many products or only one? Should the firm vertically integrate into supply or distribution activities? The pursuit of answers to these questions makes up much of the discipline within economics known as industrial organization.

The second fundamental question concerning the firm is: Who should own and who should govern the enterprise? This question also invites many others. What is the firm's optimal capital structure? How should executive compensation be structured? What should the firm's dividend policy be? If the firm is a corporation, in what jurisdiction should it be incorporated? What should the policy of management be toward unsolicited tender offers or proxy contests? How does the structure for the ownership and governance of the firm change in the face of technological or regulatory change? These questions are the domain of corporate finance.

Transactions Costs

Many of the recipients of the Nobel Prize in economics have contributed to understanding these questions of industrial organization and corporate finance.[1] A recurring theme in the analysis that they and other eminent economists have undertaken is that the set of activities that define the boundaries of the firm, and the set of contracts that define the ownership and control of the firm, depend critically on "transactions costs."

Why, for example, do some economic activities occur within the firm, while others are procured by contract in the marketplace? The famous answer that Ronald Coase gave was that a firm takes the place of contracts only when it offers lower transactions costs to produce a particular good or service.[2] So, for example, General Motors incurred lower

1. They include Kenneth J. Arrow, Ronald H. Coase, Franco Modigliani, Harry M. Markowitz, Merton H. Miller, William F. Sharpe, and George J. Stigler.

2. Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA (n.s.) 336,

transactions costs by producing car bodies internally, through its acquisition of Fisher Body, than from contractually specifying and procuring the same bodies from a separately owned and managed Fisher Body.[3] Conversely, every obstacle to cooperation that increases a firm's costs makes it less likely that the firm will exist at all; instead, the economic functions that it would perform will be conducted by individual parties assembling factors of production on an ad hoc basis—as is the case, for example, in the production of a typical motion picture.[4] Thus, economists argue that the scale, scope, and vertical integration of the firm all reflect the transactions costs of assembling and directing factors of production within a managerial hierarchy rather than through arms-length contractual relationships.

Transactions costs also affect the ownership and control of the firm. Through an evolutionary process, firms gravitate toward efficient governance structures. In particular, it is efficient to divide functions between investors and managers even though investors consequently must expend resources to specify and monitor the performance of managers.[5] Someone possessing capital may lack management expertise, and some-

386–405 (1937). Other pioneering papers in this area are Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950); Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

3. *See* Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978).

4. For a synthesis of the transactions costs literature on the nature of the firm, see PAUL R. MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT (Prentice-Hall 1992); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING (Free Press 1985).

5. *See* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–10 (1976).

one possessing management expertise may lack capital or may wish to avoid the risks of owning the productive assets that he manages. In other words, separating ownership from control facilitates risk diversification.

Risk Diversification, Moral Hazard, and Control Transactions

Financial risk, which is inherent to any economic undertaking, consists of specific risk and market risk. Specific risk is unique to a particular firm—such as the uncertainty of whether the firm will be awarded a valuable patent or win a valuable contract with an large customer. Market risk, such as the risk of war, is endemic to all firms and all industries. An investor cannot diversify away market risk, since it accompanies all economic ventures to varying degrees. In an efficient capital market, only nondiversifiable risk matters. A security that is risky in isolation, but is uncorrelated with the market, has nothing but diversifiable risk, and it will earn a return on average no higher than the return on riskless investments.

An investor can reduce the specific risk facing his portfolio by placing a relatively small share of his capital in each of a large number of investments.[6] But the more that an investor reduces the financial risk facing his portfolio by spreading his funds across many firms that seek investment capital, the smaller will be the proportion of his total wealth that depends on the performance of any given firm and the smaller, therefore, will be his incentive to oversee or participate in the management decisions facing any one of those numerous firms. "Since he holds the securities of many firms precisely to avoid having his wealth depend too much on any one firm," Eugene Fama has observed, "an individual security holder

6. *E.g.*, RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 136–39 (McGraw Hill, Inc. 4th ed. 1991).

generally has no special interest in personally overseeing the detailed activities of any firm."[7] Shareholders are "residual claimants" of the firm who contract for the right to the residual net cash flows of the venture; in contrast, salaried managers have a less immediate personal stake in the firm's profits or losses.[8] Principal-agent problems can arise when investors hire professional managers to manage the firm in which those investors have passively invested.[9] The professional managers do not internalize the costs of deviating from behavior that maximizes the firm's profit. The potential for "moral hazard" thus arises.[10]

The potential for the separation of ownership and control to cause moral hazard simply means that the firm's owners must create desirable incentives for managers through other governance mechanisms. The firm's owners, for example, can design compensation packages for managers to be an increasing function of the firm's net cash flows, an objective that could be achieved by giving these managers stock.[11] The purpose of such stock ownership by management is to align managers' incen-

7. Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 291 (1980).

8. *See* Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 328 (1983).

9. Harold Demsetz & Kenneth M. Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. POL. ECON. 1155 (1985).

10. "Moral hazard . . . . arises in agreements in which at least one party relies on the behavior of another and information about that behavior is costly. The owner of a firm hires a manager and wants the manager to maximize profits . . . . Because it is costly for the principal to know exactly what the agent did or will do, the agent has an opportunity to bias his actions more in his own interest, to some degree inconsistent with the interests of the principal." Armen A. Alchian & Susan E. Woodward, *The Firm Is Dead; Long Live the Firm*, 26 J. ECON. LIT. 65, 68 (1988). *See also* KENNETH J. ARROW, *Insurance, Risk and Resource Allocation*, *in* ESSAYS IN THE THEORY OF RISK-BEARING 134, 142-43 (1970).

11. *See* Michael C. Jensen & Kevin M. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225 (1990).

tives with those of the firm's shareholders, thereby reducing moral hazard. Another important mechanism for reducing moral hazard associated with the separation of ownership and control is the market for corporate control, in which management can be displaced by investors who acquire enough voting shares to elect a majority of the corporation's directors. An extensive literature maintains that potential competition from alternative management teams is an important means to induce managers to maximize share value.[12] In anticipation of improving share value, bidders are willing to offer premiums to the target's shareholders.

Legal Structures for Risk Bearing

Legal structures for governing a firm differ in the degree to which they allocate risk among its managers, investors, and creditors. The limited liability of a corporation permits small, risk averse investors to invest in a firm with large capital requirements that might incur operating losses or liabilities exceeding the personal wealth of any one investor. Thus, limited liability makes ownership shares more readily alienable (and thus more liquid) because, as Judge Richard Posner has observed, "without limited liability a shareholder would not even be allowed to sell his shares without the others shareholders' consent, since if he sold them to someone poorer than he, the risk to the other shareholders would be increased."[13]

12. The pioneering work is Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). For analysis of the subsequent literature, see ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (AEI Press 1993); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (Harvard University Press 1991); Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, 9 YALE J. ON REG. 119 (1992); Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSPECTIVES 21 (1988).

13. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 394 (Little, Brown & Co. 4th ed. 1992). *See also* Frank H. Easterbrook & Daniel R. Fischel, *Limited*

Although limited partners are also insulated from vicarious liability under most circumstances,[14] a partnership extends liability to a general partner to a greater degree than the typical publicly traded corporation extends liability to a shareholder, making a general partner vicariously liable for the acts or omissions of his fellow partners.[15] And, of course, an unincorporated sole proprietor only shifts risk to third parties to the extent that personal bankruptcy would permit him to shift the burden of liabilities onto his creditors.

In short, a variety of sophisticated legal institutions has developed to accommodate the demands of the capital markets to permit ownership to be separated from control and to ensure that doing so does not create significant agency costs. Most of the scholarly understanding of the function of such legal institutions did not exist as recently as the 1960s. We shall now examine how section 310(b) imposes significant transactions costs on foreign investors and U.S. licensees that seek to affiliate with one another. These costs are more than the obvious burden of hiring Washington communications lawyers, consultants, and publicists. The larger costs are the agency costs of inferior structures for ownership and control of the resulting international telecommunications venture. The FCC neither acknowledges nor bears these costs. Like all costs, however, these agency costs ultimately work their way into the price that consumers pay for the firm's services and the return that the

Liability and the Corporation, 52 U. CHI. L. REV. 89 (1985); Susan E. Woodward, *Limited Liability in the Theory of the Firm*, 141 J. INSTITUTIONAL & THEORETICAL ECON. (ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT) 601 (1985); Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499 (1976).

14. Rev. Unif. Limited Partnership Act § 303(a) (1985), 6 U.L.A. 282 (1987 supp.).

15. "Traditionally, partners are said to be jointly liable for the partnership's contractual obligations and jointly and severally liable for its tort liabilities." ROBERT C. CLARK, CORPORATE LAW 6 (Little, Brown & Co. 1986). *See also* Unif. Partnership Act § 15, 6 U.L.A. 174 (1916).

firm's owners earn on their invested capital.

THE STATUTORY SCHEME

Section 310(b) of the Communications Act restricts foreign ownership or management of broadcast, common carrier, or aeronautical en route or aeronautical fixed radio station licenses. First, consider application of this ban under sections 310(b)(1) and 310(b)(2). These sections apply the ban to "any alien or the representative of any alien" and to "any corporation organized under the laws of any foreign government."[16] Here we see the first level of distortion of business behavior caused by the statute. Individual aliens who want to hold U.S. radio licenses simply may not; they must incur the costs of finding some other, more removed corporate vehicle to hold the license on their behalf, either as remote investors or as customers.

Those aliens who do not give up altogether in their attempt to make a direct investment in a U.S. wireless company would proceed under section 310(b)(3) or 310(b)(4), neither of which absolutely bars alien affiliation. Rather, these provisions ban only certain configurations of equity interest and alien involvement with management. Additionally, aliens who would not have been interested in holding a license but who merely want to make an investment in a licensee will seek to operate under these sections. Thus, the FCC decisions we will review throughout this chapter involve the application of sections 310(b)(3) and 310(b)(4). It is the interpretation of these provisions that determines the extent of the transactions costs that any alien investor must bear.

Section 310(b)(3) governs the level of permissible alien investment directly in a licensee. The section applies to "any corporation of which any officer or director is an alien or of which more than one-fifth of the capital stock is owned of

16. 47 U.S.C. §§ 301(b)(1), (2).

record or voted by aliens or their representatives or by a foreign government or representatives thereof or by any corporation organized under the laws of a foreign country."[17] The practical effect of the provision is to ban licensees from raising capital by selling more than 20 percent of their stock to foreign buyers.

Section 310(b)(4) governs the level of alien investment in a licensee's holding company, applying to "any corporation directly or indirectly controlled by any other corporation of which any officer or more than one-fourth of the directors are aliens, or of which more than one-fourth of the capital stock is owned of record or voted by aliens, their representatives, or by a federal government or representative thereof, or by any corporation organized under the laws of a foreign country, if the Commission finds that the public interest will be served by the refusal or revocation of such license."[18] In some cases, choosing between section 310(b)(3) and 310(b)(4) is straightforward. Obviously, section 310(b)(3) would apply to an alien seeking to purchase stock of a licensee. Likewise, section 310(b)(4) would apply to an alien seeking to purchase stock in a holding company (that is, a company that holds a controlling interest in a licensee). Suppose, however, that the alien seeks to buy stock in a corporation that is not itself a licensee, but which owns a noncontrolling interest (less than 50 percent) in a licensee. Then, the FCC will apply section 310(b)(3), not section 310(b)(4).[19]

This glance at sections 310(b)(3) and 310(b)(4) reveals two ways in which these provisions might affect an investor's transactions costs. First, investors must incur costs to comply with the restrictions in each provision. Second, the FCC may

17. *Id.* at § 301(b)(3).

18. *Id.* at § 301(b)(4).

19. Ronald W. Gavillet, Jill M. Foehrkolb & Simone Wu, *Structuring Foreign Investments in FCC Licensees Under Section 310(b) of the Communications Act*, 27 CAL. W.L. REV. 7, 10-11 (1990).

decline to enforce the restrictions of section 310(b)(4) if "the public interest" requires it. Investors must therefore consider the costs of this waiver process. The extent of those compliance costs becomes clearer upon examining the scope and nature of the FCC's enforcement of section 310(b). In addition to these direct compliance costs, investors incur agency costs that could otherwise be avoided if section 310(b) did not constrain their choice of structures for the ownership and control of a U.S. radio licensee.

FCC ENFORCEMENT PREROGATIVES

The Communications Act empowers the FCC to enforce section 310(b) in a variety of contexts. The FCC might be called on to enforce section 310(b) in an application proceeding for an initial grant of license,[20] in a license renewal proceeding,[21] in an application to transfer control of a license,[22] or in a license revocation proceeding.[23] Even if the FCC has approved an alien's affiliation with a licensee on many occasions, this does not insulate the affiliation from later FCC review.[24] When

20. Jireh's Broadcasting, L.P., 5 F.C.C. Rcd. 3308, 3309 ¶ 4 (1990) (dismissing application because alien partner whose U.S. citizenship was pending never filed an amendment indicating subsequent grant of citizenship); Edward F. & Pamela J. Levine, 6 F.C.C. Rcd. 4679, 4769 ¶ 3 (1991) (application will be dismissed when it does not contain information to verify compliance with section 310(b)); Loudon Broadcasters, Inc., 3 F.C.C. Rcd. 796, 796 ¶ 2 (1988), *recon. dismissed sub nom.* Lauderdale-McKeeham Christian Broadcasting Corp., 4 F.C.C. Rcd. 8095 (1989).

21. *See* Spanish Int'l Comm. Corp., 2 F.C.C. Rcd. 3336, 3339 ¶ 14–16 (1987) (*SICC*), *aff'd sub nom.* Coalition for the Preservation of Spanish Broadcasting *v.* FCC, 931 F.2d 73 (D.C. Cir. 1991), *cert. denied*, 502 U.S. 907 (1991); *see also* Fox Television Stations, Inc., 77 Rad. Reg. 2d (P & F) 1043, 1046 ¶ 5 (1995) (*Fox*).

22. *See* 47 U.S.C. § 310(d).

23. *See* KOZN FM Stereo 99, Ltd., 59 Rad. Reg. 2d (P & F) 628, 629 ¶¶ 4, 7 (1986).

24. Seven Hills Television Co., 2 F.C.C. Rcd. 6867, 6868–74 ¶¶ 7–27

section 310(b)(1), 310(b)(2), or 310(b)(3) is involved, the FCC will consider only the issue of compliance. When section 310(b)(4) is involved, the FCC may consider not only compliance with the limits on ownership, officers, and directors, but also whether to waive those limits. The FCC asserts the power to approve a transaction only on condition that it give prior approval to further changes in corporate structure.[25] In this manner the agency becomes a third party in corporate governance.

FCC has construed section 310(b)(4) to grant it discretion to permit alien ownership beyond the 25 percent benchmark of section 310(b)(4) if the investor and licensee can show that the investment would be in the public interest. As chapter 3 explained, the FCC has misread the plain language of section 310(b)(4). The statute actually requires the FCC to show that the public interest would call for the applicant's licensee to be revoked or denied. Nevertheless, the FCC's construction still stands—though it was disowned by the House Commerce Committee in 1995[26]—and, for the time being, it is this agency *mis*interpretation of the statute with which the alien investor must contend in his business planning.

The FCC's waiver process for section 310(b)(4) adds uncertainty to any investment that would come under that subsection. Its inquiry into whether the grant of a section 310(b)(4) waiver will serve the public interest is essentially arbitrary, as chapter 5 documents in the cases of the largest foreign investments made in U.S. telecommunications firms as of 1995. The FCC has a laundry list of factors, many of which bear little or no relation to the statute's original purpose. The factors that do relate to the statutory purpose are applied with inexplicable zeal. The decisions on waivers under section

(1987), *recon. dismissed*, 3 F.C.C. Rcd. 826 (Rev. Bd. 1988), *recon. denied* 3 F.C.C. Rcd. 879 (Rev. Bd. 1988), *rev. dismissed* 4 F.C.C. Rcd. 4062 (1989).

25. Gavillet, Foehrkolb & Wu, *supra* note 19, at 49.

26. H.R. REP. No. 204, 104th Cong., 1st Sess. 120–21 (1995).

310(b) exemplify Judge Henry Friendly's observation that the authors of FCC opinions "remain free to pull [prior authorities] out of the drawer whenever the agency wishes to reach a result supportable by the old rule but not the new."[27]

The FCC describes the history of its inquiry in section 310(b)(4) cases as follows:

> [T]he Commission . . . has generally considered the following factors: national security, the extent of alien participation in the parent holding company, and the nature of the license, including whether the licensee exercises control over content. In addition, the Commission may consider any other public interest factors appropriate . . . . One of the Congress' principal reasons for enacting Section 310 of the Communications Act of 1934 was its concern for national security and preventing alien activities against the government during a time of war. Accordingly, the Commission has traditionally sought to ascertain whether a country with which a prospective licensee or its parent is associated enjoys "close and friendly relations with the United States" and, therefore, is not a "national security concern." . . . The Commission has also traditionally considered the extent of alien participation in the parent corporation of a Title III radio licensee. More specifically, the Commission has considered where the parent corporation is incorporated (the United States or elsewhere); the citizenship of the stockholders, officers and directors of the parent corporation; and whether there are intermediate corporations between the licensee and the parent

27. HENRY J. FRIENDLY, THE FEDERAL ADMINISTRATIVE AGENCIES 63 (1962).

> corporation that are incorporated in the United States, are owned by U.S. citizens or interests, and have U.S. officers and directors. In addition, the Commission has traditionally considered the type of radio license at issue in assessing whether the public interest would be disserved by foreign ownership in a parent corporation exceeding the Section 310(b)(4) benchmarks. For example, the Commission has concluded that concern about the effect of foreign ownership on national security is lessened when common carrier radio licenses are involved because they are "passive" in nature and the licenses confer no control over the content of transmissions. Finally, the Commission may also consider other relevant factors, including the furtherance of established Commission policies such as increased competition or the wide dissemination of licenses.[28]

Among the "other relevant factors" the FCC has considered are a concern with preserving U.S. jobs.[29] The FCC has also inquired into the licensee's need for capital and into the value of the services the company provides, second-guessing management in the first case and customers in the second.

The FCC has acknowledged that section 310(b) was enacted because of national security concerns.[30] The FCC's view as of 1995, however, seemed to be that such concerns were anachronistic:

28. Market Entry and Regulation of Foreign-affiliated Entities, Notice of Proposed Rulemaking, IB Dkt. No. 95-22, 10 F.C.C. Rcd. 5256, 5263–64 ¶¶ 15–19 (1995) [hereinafter *Market Entry and Regulation*].

29. Gavillet, Foehrkolb & Wu, *supra*, note 19, at 17, 49.

30. *Market Entry and Regulation*, 10 F.C.C. Rcd. at 5263 n.16.

> The original national security rationale for limiting foreign ownership in a parent corporation has less applicability today than it had in the 1930's. Today there is a plethora of service providers. No single licensee which is owned in part by a foreign corporation could take over the wireless or wireline services in the United States in a time of war.[31]

The FCC therefore suggested in 1995 adopting trade policy as an additional determinant of the public interest when considering requests for waivers under section 310(b)(4), as well as when processing foreign carriers' section 214 applications.[32] As chapter 7 will discuss in greater detail, the FCC has proposed a reciprocity test, under which the determining factor would be whether the governments of a foreign carrier's "primary markets" permit U.S. citizens to invest in similar licensees:

> [W]e propose the addition of an effective market entry standard to our public interest analysis of foreign carrier entry applications under Section 214 as a tool to encourage foreign administrations to open their markets to U.S. entities. This, in turn, will eliminate opportunities for foreign entities to engage in conduct that might have anticompetitive effects in the provision of international services or facilities, including undue discrimination or other abuses of bottleneck facilities, and will promote effective global market competition. We also request comment on whether our goals in this proceeding will be furthered by incorporating the effective market

31. *Id.*
32. *Id.* at 5269 ¶ 33.

> access test as an element of our Section 310(b)(4) analysis for Title III common carrier, aeronautical and broadcast license applications.[33]

Reed Hundt, chairman of the FCC, stated that "section 310(b) legislation which links effective access to overseas markets to access our own markets" would more effectively serve the public interest than the present section.[34] He urged that "any legislation which enacts an effective market approach should vest the FCC with the discretion—as does the current section 310(b)(4) to determine on a case-by-case basis whether the standard is met."[35]

The FCC has claimed broad latitude in interpreting "the public interest." In the case of waivers under section 310(b)(4), it is extraordinary how far the FCC has wandered from the concerns with national security that motivated section 310(b). Should the FCC adopt its new trade policy proposal, the FCC will have strayed even farther from the law's intended purpose, and the outcome of the agency's waiver inquiries will be even more uncertain.[36] Not only has the FCC never laid down rules as to what will be allowed and what will not, opting instead to decide each waiver on a case-by-case basis that maximizes agency control over international investment decisions, but the policies adopted in one case might not be the same policies

33. *Id.*

34. *Hearings on Section 310 of the Communications Act of 1934 Before the Subcomm. on Commerce, Trade, and Hazardous Materials of the House Comm. on Commerce*, 1995 F.C.C. LEXIS 1423, *2 (Mar. 3, 1995) (statement of Reed E. Hundt, Chairman, Federal Communications Commission).

35. *Id.*

36. Addressing its treatment of foreign carriers' section 214 applications, the FCC has acknowledged that case-by-case review leads to uncertainty: "[O]ur case-by-case review of foreign carrier applications has caused uncertainty in the market due to the lack of a clear standard for evaluating applications by foreign carriers with different degrees of market power in their home markets." *Market Entry and Regulation*, 10 F.C.C. Rcd. at 5266 ¶ 23.

adopted in another. This arbitrariness has added a further element of risk to business planning under section 310(b).

In short, compliance with section 310(b) is a continuing obligation. Section 310(b) requires the licensee and the would-be foreign investor (or consultant, or officer, or director) to adjust all his dealings, all the time, to comply with section 310(b). The gymnastics that managers, investors, and lawyers must perform to comply with section 310(b) raise transactions costs that distort the design of the efficient scale, scope, ownership, and control of firms that seek to compete as full-service networks for international telecommunications.

WAIVERS FOR FOREIGN OFFICERS AND DIRECTORS

One means by which an investor may monitor his investment is by becoming involved in with the firm's management. Section 310(b)'s restrictions on alien officers and directors frustrate this effort to reduce agency costs.

Section 310(b)(3) bars "any corporation of which any officer or director is an alien" from holding most kinds of radio licenses, including a license to broadcast radio or television programming or to serve as a common carrier.[37] The FCC has no discretion under section 310(b)(3) concerning alien officers and directors.[38] The presence of a single foreign officer or director in a radio licensee violates the restriction.

Section 310(b)(4) bars holding companies of licensees from having any alien officer, or having more than one-fourth aliens on the board of directors, "*if* the Commission finds that

37. 47 U.S.C. § 301(b)(3).

38. *See* Request for Declaratory Ruling Concerning the Citizenship Requirements of Sections 310(b)(3) and (4) of the Communications Act of 1934, *as amended*, 103 F.C.C.2d 511, 524 ¶ 21 (1985) (*Wilner & Scheiner*), *reconsidered in part*, Reconsideration Order, 1 F.C.C. Rcd. 12 (1986) (*Reconsideration Order*).

the public interest will be served by the refusal or revocation of such license."[39] The FCC has interpreted this language to establish a presumption that these affiliations are not in the public interest, but the agency will grant waivers of the limits. Virtually all waiver requests under section 310(b)(4) have concerned restrictions on the citizenship of alien officers and directors of the holding company, as opposed to the stock ownership limitations on the holding company. In considering whether to waive the limits on alien officers and directors imposed by section 310(b)(4), the FCC considers the scope or its "public interest" inquiry to be broad and to encompass, among other considerations, the following factors.[40]

Is the Alien's Country of Citizenship Friendly?

In assessing the extent to which alien officers or directors could pose a national security threat, the FCC will consider whether the alien's country of citizenship has close and friendly relations with the U.S.[41] Under this standard, the FCC has approved licenses where the licensee's parent corporation had 50 percent Canadian directors,[42] and one in which one officer was Canadian.[43] The FCC also approved licenses where four of the parent's directors were Swedish, British, and Swiss,[44] and

39. 47 U.S.C. § 301(b)(4) (emphasis added).

40. *See* Regulatory Policies and International Telecommunications, 2 F.C.C. Rcd. 1022, 1032 ¶ 73 (1986) [hereinafter *Regulatory Policies*]; Gavillet, Foehrkolb & Wu, *supra* note 19, at 49.

41. *Regulatory Policies*, 2 F.C.C. Rcd. at 1032 ¶ 73 & n.126.

42. Vermont Tel. Co., 1995 F.C.C. LEXIS 3130, *1-2 ¶¶ 4-5 (May 8, 1995).

43. Application for Consent to Transfer Control of Hughes Communications, Inc. to General Motors Corp., 59 Rad. Reg. 2d (P & F) 502, 502 ¶ 5 (1987).

44. Comsat Gen'l Corp., 3 F.C.C. Rcd. 4216, 4218 ¶¶ 24-26 (1988).